participate again. Only 3 percent noted that they may wish to reconsider their participation.

Expectations

With a continuing concern about the high level of youth unemployment, in particular for minority and disadvantaged youths, a number of communities are considering the feasibility of building upon the success of summer-job programs to create year-round operations. This has been a long-range goal of the New York Partnership's Summer Jobs for Youth/82, as well as of similar programs in other cities.

Those who are assigned responsibility for structuring a year-round program are familiar with the very real differences between these two kinds of efforts. While the summer-job program is a relatively limited, inexpensive program—staffed largely by volunteers and providing marginal jobs with little or no training content—the full-year program would require a permanent cadre of trained specialists to find meaningful positions. The jobs should have career potential, and such training as may be necessary to prepare an unskilled young person for regular employment. Certain aspects of the summer programs, particularly the voluntary organization structure, the cooperation with public-sector agencies and community organizations, and the marketing and media activities, are components transferable to a year-round operation. However, an altogether different set of aims would have to be applied—emphasizing fewer but better-quality placements.

Another major consideration is the dichotomy between the accepted view that businesses are cost conscious and rationally aim for maximum productivity, and the goal of a year-round job program that asks businesses to hire youth because they need the jobs. While a summer-job program can bridge this philosophical gulf because it is short-term and inexpensive, a similar approach, as a standard for a yearly business operation, would not be acceptable for many companies.

The survey indicated that the leading motives for hiring summer workers were an interest in advancing opportunities for youth and an act of social responsibility. In the long run, for a full-time program, the choice may be between the real needs of businesses and the things they can afford to do for needy youth.

Experiences of Selected Cities

This section presents an overview of Summer, 1982, programs coordinated by the private sector in 14 cities. Highlighted are each city's goals, experiences and effectiveness in coping with the overall problem.

Except where otherwise noted, the unemployment data were provided by the U.S. Bureau of Labor Statistics (BLS). In general, the jobless figures should be seen as *understatements* of the problem within each city. First of all, the data are for August, 1981, the latest summer month for which such figures were available on a city-by-city basis. It can be safely assumed that in most, if not all, of these cities, the rate was actually higher, in accordance with the nationally reported seasonally adjusted increase. In August, 1982, the national youth unemployment rate for both sexes and all races was 24 percent, up four points over the previous year. (Minority youth unemployment, as usual, was considerably higher.) In absolute numbers, that meant an additional 291,000 young people idled, for a total of over two million unemployed youths. Furthermore, the BLS counts as youths only those between the ages of 16 and 19, whereas most corporate youth programs include people up to 21. Finally, the BLS specifically excludes youths classified as "discouraged"—those who have given up looking for work after an extended period of fruitless job searches.

Small Inroads

Perhaps the outstanding finding in the present survey is that the dent in youth joblessness made by private-sector efforts was, in most cases, miniscule. Chicago, for example, placed only 730 youths out of at least 37,000 out of work—under 2 percent. And that percentage, again, is an overestimate in light of the factors cited above.

The situation was much the same for the other cities, with the exception of New York and Houston. The New York City effort was by far the most extensive of the private-sector undertakings—fully computerized, staffed by over 200 volunteers, employing a massive publicity campaign, and planned for a full year. Sponsored by the New York City Partnership, the project obtained over 15,700 jobs. But the official youth unemployment figure, underestimated, was 55,000. This means that the New York effort would have had to come close to tripling its effectiveness rate to have a substantial impact on the problem.

Asked why he thought more headway had not been made, a representative of the Partnership, Walter Heithaus, likened the problem of summer youth unemployment to "pushing a manhole cover across 42nd Street with your nose."

"Why didn't we get 100,000 jobs? Because we were not organized to get them. What we did was a start, and we are still in the process of improving the system of matching the jobs with the jobless. We have not stopped doing that." While commenting on the cooperative nature of the project—government, labor and community groups were participants—Heithaus emphasized that: "The solution lies partly in the private sector. The effort simply has to be bigger." It is likely that the New York City program will serve as a model for undertakings in other areas. Project coordinators from several cities mentioned that they had visited the Partnership headquarters during the Summer to review operations.

No matter how large or well-coordinated the effort, however, no significant improvements can be expected in cities where there are virtually no private jobs to be had. For three of the cities in this report, in fact, no private-sector positions were secured at all. Instead, project coordinators were able at best to receive cash contributions from the firms to place youths on community projects or in government agencies. In general, youths so employed were involved in neighborhood-improvement projects, in social-service delivery, or in entry-level clerical positions.

Trends

Interviews with program administrators revealed a number of emerging trends in summer employment projects. Establishment of numerical goals, in terms of youths to be employed, is no longer as popular as it had been in the past. Even in cities where the economic base is not deeply depressed, goal setting is often considered as much a drawback as a help. "It becomes a numbers game," one administrator noted, adding that the time and energy placed in developing figures for final reports would be more productively spent in securing work sites or cash donations.

In cities so severely hit by the recession that private-sector jobs could not be obtained, efforts were made to place youths on community projects that had some significance beyond merely serving as a workplace. "After the Summer we talked to the kids involved, and they really felt a sense of accomplishment in bringing back to life a park that had been neglected for about 20 years," explained a representative of the Cleveland project. "Now that park will be used for community activities." Related to the feeling of accomplishment among the youths was their reported satisfaction in being identified with specific corporate sponsors.

Satisfaction was not restricted to the employees. Numerous program administrators emphasized that employers themselves "had their own stereotypes demolished," as one coordinator said. Company managers were consistently reported to be pleasantly surprised at the quality of the young workers, in terms of high productivity and willingness to work. This is borne out by the survey finding that 70 percent of the firms indicated it was possible to carry over some summer employees to year-round jobs.

Relating jobs directly to education is a concept growing in popularity. Coordinators for projects in several cities offered their local school system a strong incentive: that students whose math and reading skills, attendance and other standards showed marked improvement would be first in line for the jobs. Boston has formalized this concept into The Boston Compact, under which cooperating businesses offer a specific number of jobs to graduates if the schools meet a set of clearly defined educational improvement goals.

Because such arrangements tend to provide for a more direct corporate involvement in the school system in terms of planning and personnel, they have been greeted with both praise and skepticism. While applauding the additional resources for the schools, some critics have raised questions concerning possible long-range effects. As one education observer noted in *The Christian Science Monitor:* "A century ago schools were built to look like factories—ensuring a tractable work force whose aspirations went no further than the local mill. Is this a return to a view that educational policy is to be guided not by the long-range needs of the students but by the immediate wishes of employers?"[10] The same reporter answered in the negative, based on a reading of the actual plan, and went on to urge the corporate sector to support the Compact.

Perhaps the most encouraging trend is that most, if not all, of the coordinated summer projects will be undertaken again in the Summer of 1983. In fact, in many cases preparations began as early as September 1982, as administrators stressed the importance of early planning and the need to secure broadly based participation. The more complete the involvement by the private, public and community sectors, the more likely the success of the endeavor, according to the coordinators.

But success is a relative term. If it means making a start, or catalyzing and coordinating the activities of a variety of companies and other organizations, all the projects described in this report were successful—at least according to the coordinators. If, however, success is measured in terms of reducing the overall youth-unemployment problem, then the private-sector operations have not been shown to be superior to the governmental programs.

Nor is it likely that the Federal Government will increase much of its own support in this area. As of this writing, the House and Senate had reached agreement on a $4.6 billion emergency jobs bill, $100 million of which would go for additional summer jobs for youth. However, the impact on summer youth unemployment, as well as on unemployment in general, was not expected to be significant. As House Minority Leader Robert H. Michel (R-Ill.) noted during the congressional deliberations: "As a matter of fact, that blip of four-tenths of one percent in the unemployment rate (from 10.8 to 10.4 percent in January 1983) created far more jobs than we're going to be able to create in this package we're talking about."[11]

Following are the highlights of corporate-administered programs for each of the 14 cities studied.

[10]Rushworth M. Kidder, "The Boston Compact: Breaking the Stalemate in the Public Schools," *The Christian Science Monitor,* September 30, 1982.

[11]Helen Dewar and Juan Williams, "Don't Alter Jobs Offer, GOP Says," *Washington Post,* February 16, 1983.

BALTIMORE

Youth Unemployment	21,000 (21.6 percent)
Numerical Goals	1,000 jobs
Youths Employed	1,740
Private Sector Jobs	800
Community or Agency Jobs made possible through cash contributions	940
Corporate Participants	350

Government Participants

Public school system, Mayor's office.

Other Participants

City employees donated or raised $60,000. Community groups provided openings and volunteers.

Employer Recruitment

Job-solicitation efforts were coordinated by the Private Sector Steering Committee, comprising representatives from the Private Industry Council, the Voluntary Council, the Greater Baltimore Committee, and Help Unite Baltimore (a black business leaders' organization). The PSSC secured volunteers from member companies to solicit job offers by phone.

Youth Recruitment

For private-sector jobs, youths were recruited through the public school system. Economic need and school performance were the selection criteria. For non-private-sector jobs, the regular Summer Youth Employment Program, funded by the U.S. Department of Labor, was used.

Publicity

Numerous press conferences were held, one for each new phase of the project or each new major participant. One hundred thousand brochures were mailed to corporations.

Miscellaneous

Cooperation by many sectors was recognized as key to the project's success. According to a survey by the coordinator, 96 percent of the employers agreed to cooperate in the Summer of 1983.

Project Coordinator

Mayor's Office of Manpower Resources, 701 St. Paul Street, Baltimore, Maryland 21202.

* * * *

BOSTON

Youth Unemployment	17,000 (14.2 percent)
Numerical Goals	750 jobs
Youths Employed	852
Private Sector Jobs	852
Community or Agency Jobs made possible through cash contributions	—
Corporate Participants	152

Government Participants

Prime CETA sponsor; school system.

Other Participants

54 community organizations.

Employer Recruitment

Personal and written requests to CEO's on Private Industry Council's board of directors and in Chamber of Commerce. Each PIC board member also made personal calls to targeted CEO's. Project staff solicited jobs through phone calls.

Youth Recruitment

School system; panels of teachers and company representatives matched students to jobs and arranged for interviews.

Publicity

Start-up press conference in March resulted in articles in the daily and weekly press and a television talk show. According to the project coordinator, the media viewed the Boston summer youth project as a "soup to nuts"

program that went beyond hiring, to counseling and follow-up.

Miscellaneous

Following Boston's first summer employment program in 1981, the Private Industry Council perceived a need to sustain a year-round effort in conjunction with the public schools. Industry and education leaders developed the Job Collaborative, under which interdisciplinary teams in selected high schools provide special services for youths in career education, remedial reading and math, placement in unsubsidized jobs, and monitoring employment and education after graduation. Participating youths are those who have experienced trouble in school or in finding jobs, but they must adhere to "strict performance standards." Private employers are involved in "all aspects of the program, from guidance and instruction to job placement and financial support," according to a program description.

A second program, called The Boston Compact, is a strategy by business to use jobs as a "powerful motivator" for students, teachers and school administrators. Under the Compact, schools commit themselves to measurable goals in terms of reading ability, dropout declines, and so forth. Likewise, cooperating businesses commit themselves to the goal of "a 5 percent increase per year in the number of graduates who are placed in jobs or in further education."

Project Coordinator

Boston Private Industry Council, 110 Tremont Street, Boston, Massachusetts 02108.

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CHICAGO

Youth Unemployment	37,000 (16.5 percent)
Numerical Goals	None
Youths Employed	730
Private Sector Jobs	700
Community or Agency Jobs made possible through cash contributions	30
Corporate Participants	45

Government Participants

Board of Education, Mayor's Office of Employment and Training.

Other Participants

Chicago Urban League, plus 25 community groups.

Employer Recruitment

Mail campaign, word of mouth.

Youth Recruitment

School system and Chicago Urban League.

Miscellaneous

Central concept was to use jobs program as an educational stimulus. Schools were informed that students with higher grades and better attendance would be first in line for summer jobs. Career counseling and course assessment were built into project. At end of project, youths addressed a number of the CEO's on their work experiences.

Plans for 1983 are considerably more ambitious, with an unofficial goal of 14,000 placements.

Project Coordinator

Chicago United, 6 North Michigan Avenue, Chicago, Illinois 60602.

* * * *

CLEVELAND

Youth Unemployment	12,000 (18.8 percent)
Numerical Goals	None
Youths Employed	125
Private Sector Jobs	—
Community or Agency Jobs made possible through cash contributions	125
Corporate Participants	24

Government Participants

School system, Mayor's office.

Other Participants

Cleveland Foundation, YMCA, church groups, community organizations.

Employer Recruitment

Massive mailing requested direct hires. According to the project coordinator, this effort was not successful, given a late start and Cleveland's severely troubled economy. Additional efforts included a mailing to 100 targeted major companies, plus follow-up phone calls to CEO's. Coordinator's chairman held a meeting for 20 select corporations requesting their backing.

Youth Recruitment

Youth Service Coordinating Council representing local Y's, public school system, and other groups referred youths to project coordinator.

Publicity

Public service television announcements by Mayor and other participants. Articles in business and labor publications and general media. Brochure distribution.

Miscellaneous

Aim was to stimulate as much activity within the private sector as possible—if not in jobs then in cash contributions. Youths placed on community- or city-work projects were thus sponsored by particular corporations. Each company sponsored either a complete work team consisting of four youths plus a supervisor, or a single team member.

According to project coordinator, many youths expressed satisfaction at two aspects of the project: being identified with a major corporation, and working on worthwhile tasks such as restoration of neglected city parks.

Project Coordinator

Manpower and Education Resources Center (Metropolitan Cleveland Jobs Council), 690 Union Commerce Building, Cleveland, Ohio 44115.

* * * *

DETROIT

Youth Unemployment	35,000 (21.0 percent)
Numerical Goals	None
Youths Employed	400
Private Sector Jobs	—
Community or Agency Jobs made possible through cash contributions	400
Corporate Participants	16

Government Participants

Parks and Recreation Department, school system, Department of Manpower.

Other Participants

United Auto Workers, Police Athletic League, Hudson-Weber Foundation, plus about 20 community organizations and churches. Sponsors included National Alliance of Business and Private Industry Council.

Employer Recruitment

Personal meetings with community affairs and public affairs officials of major corporations, plus follow-up mail and phone campaign.

Youth Recruitment

Referrals from community groups and churches.

Publicity

Letters sent to media resulted in radio and television spot announcements and appearances on television talk shows. Project coordinator has well-established public relations operation with ongoing cooperation from local media.

Miscellaneous

Beneficiaries of the Detroit program were senior citizens, who received free home repairs; young students, who received free tutoring service; and the general public through repairs to parks and swimming pools. According to project coordinator, efforts were made to place youths in jobs that were "meaningful, not make-work."

Funds from the Hudson-Weber Foundation allowed for additional employment of supervisors. United Auto Workers provided training staff and facilities, and corporations provided volunteer administrative staff and equipment.

Project Coordinator

New Detroit Inc., Commonwealth Building, Detroit, Michigan 48226.

* * * *

HOUSTON

Youth Unemployment	7,000 (8.0 percent)
Numerical Goals	5,100 plus
Youths Employed	3,000
Private Sector Jobs	3,000
Community or Agency Jobs made possible through cash contributions	—
Corporate Participants	no information available.

Government Participants

Texas Employment Commission, school system.

Other Participants

National Day Care Centers of America, Volunteer Action Centers of Harris County, several church groups.

Employer Recruitment

Houston Chamber of Commerce mailed requests in April to 8,700 corporations, signed by Mayor, Chamber of Commerce chairman and local representative of President's Task Force on Private Sector Initiatives. A follow-up phone-a-thon was staffed by corporate and civic volunteers.

Youth Recruitment

School system established five centers throughout the city where job-search training seminars were conducted. Job applications were distributed to all school counselors.

Publicity

Television spot announcements, features and public-affairs programs, plus local newspaper coverage.

Project Coordinator

Greater Houston Alliance of Business, 3637 West Alabama, Suite 340, Houston, Texas 77027.

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LOS ANGELES

Youth Unemployment	56,000 (22.0 percent)
Numerical Goals	8,500
Youths Employed	6,900
Private Sector Jobs	6,900
Community or Agency Jobs made possible through cash contributions	—
Corporate Participants	2,000

Government Participants

School system.

Employer Recruitment

Arranged by major bank in Los Angeles that served as project sponsor.

Youth Recruitment

School system; project coordinator distributed brochures on job-seeking tips.

Publicity

Radio interviews with sponsor, local newspaper coverage.

Miscellaneous

Summer employment program has been in operation since 1975, and will continue into indefinite future.

Project Coordinator

Youth Opportunities Unlimited, P.O. Box 3307, Los Angeles, California 90051.

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MIAMI

Youth Unemployment	9,000 (7.8 percent)
Numerical Goals	None
Youths Employed	940
Private Sector Jobs	940
Community or Agency Jobs made possible through cash contributions	—
Corporate Participants	60

Government Participants

State Employment Service, Partners for Youth (Dade County Government), Dade Community Revitalization Board, school system.

Other Participants

Troubled Children Foundation, numerous community groups.

Employer Recruitment

Mail campaign. All jobs were listed with the State Employment Service.

Youth Recruitment

Florida State Employment Service, community organizations.

Publicity

Start-up press conference was held in April. All local television stations were contacted, and agreed to produce public-service spot announcements throughout the Summer. Radio spots were also secured. Articles appeared in daily and community newspapers. Radio and television talk shows featured staff of the Private Industry Council and other participating organizations. Additional publicity consisted of bumper stickers, aerial advertisements, and posters on bus benches and billboards. Airport computer sign flashed a "hire youths" message for 15 minutes every hour.

Miscellaneous

Major aim of project was to target all companies employing five or more people. Another aim was to locate as many jobs as possible in areas near to youths' own residences to minimize transportation expense. Both aims were accomplished—at least in part. Project coordinator attributed success of project to "comprehensiveness of the effort and the shared responsibilities and resources of separate agencies working to overcome bad times." For 1983, operations began earlier in the year, with added emphasis on active business participation. "Business appealing to business has proved to be more successful than traditional public-sector appeal to business."

Project Coordinator

Private Industry Council of Dade County, Inc., 6555 N.W. 36th Street, Miami, Florida 33166.

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NEW YORK CITY

Youth Unemployment	55,000 (28.5 percent)
Numerical Goals	15,000 jobs
Youths Employed	15,789
Private Sector Jobs	15,789
Community or Agency Jobs made possible through cash contributions	—
Corporate Participants	1,500

Government Participants

Board of Education, City Department of Employment, State Employment Service.

Other Participants

Career Opportunities for Brooklyn Youth (a multibusiness, labor and community partnership), Private Industry Council, New York Chamber of Commerce and Industry, several private foundations, numerous community and civic organizations.

Youth Recruitment

City Department of Employment referred youths who could not be accommodated by the regular Summer Youth Employment Program. CETA funds, however, provided public-sector jobs for about half the applicants. All youths were from families with incomes below the lowest income level of a hypothetical "self-sufficient urban family of four," as established by the U.S. Bureau of Labor Statistics. In New York City, that level was $15,704 in Fall, 1981.

Employer Recruitment

Massive outreach consisted of several million flyers accompanying utility and other bills; 55,000 letters sent to private firms; 20,000 phone calls made by 200 volunteers. Special efforts included 125 students from the City University of New York making bus trips through each of the five boroughs canvasing for jobs. (They raised 300 offers.).

Publicity

Publicity was conducted by a private advertising firm on a pro bono basis. Its aim was to make "Summer Jobs for Youth" a household phrase. Project coordinator urged business firms to devote part of their advertising budgets to run Summer Jobs for Youth public-service announcements, and to print ads asking employers for jobs. Commercials were aired between innings of New

York Yankee games. Transit posters were used, and frequent press events were held.

Miscellaneous

The New York project was probably the largest in the country. The undertaking is administered by a different company each summer, on behalf of the New York City Partnership. The 1982 coordinator was Citicorp (which made use of its branches throughout the city for employer recruitment). In 1983, Philip Morris will administer the program.

Project Coordinator

New York City Partnership, Inc., 200 Madison Avenue, New York, N.Y. 10016.

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OMAHA

Youth Unemployment	22,598 (14.1 percent[a])
Numerical Goals	None
Youths Employed	310
Private Sector Jobs	310
Community or Agency Jobs made possible through cash contributions	—
Corporate Participants	10

Government Participants

Omaha Finance Department.

Other Participants

Small Business Council of Greater Omaha, Chamber of Commerce.

Employer Recruitment

Prime CETA sponsor, articles in newsletter of Small Business Council, personal contact of CEO's.

Youth Recruitment

School system, public-service media announcements.

Publicity

No specific media campaign, since summer youth employment considered inherently media worthy by project coordinator. Newspapers provided adequate coverage.

Miscellaneous

Most of the work on the program was administered by staff of local CETA sponsor. According to project director: "We principally solicit the funds from the business community here, turn the funds over to the Finance Director for the City of Omaha, and then coordinate with that director and the CETA executive director in the administration of the program. The CETA staff members do such an outstanding job that there is very little for us to do in the area of administration."

Project coordinator donated $150,000 and requested another $100,000 from the business community. In response, a local foundation provided $67,000, and corporations contributed an additional $75,000. Funds were then used to supplement regular CETA program.

Project Coordinator

Corporate Community Relations, Internorth, 2223 Dodge Street, Omaha, Nebraska 68102.

[a]Projected for full year 1982 by Nebraska Department of Labor. The 14.1 percent figure is an average of projections for two age groups: 16 to 17-year olds (18.5 percent unemployment) and 18 to 19-year olds (9.7 percent unemployment).

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PITTSBURGH

Youth Unemployment	17,000 (20.8 percent)
Numerical Goals	None
Youths Employed	210
Private Sector Jobs	—
Community or Agency Jobs made possible through cash contributions	210
Corporate Participants	25

Government Participants

CETA Sponsor, Parks Department, school system.

Employer Recruitment

Chairman of Private Industry Council addressed business groups and initiated a follow-up letter to corporate CEO's.

Youth Recruitment

School system, CETA sponsor.

Publicity

Newspaper articles, television talk shows, and special events coverage throughout the project.

Miscellaneous

Funds raised by the Private Industry Council were used to employ 41 supervisors, while Community Development funds (moneys made available through the Federal Community Development Block Grant program) were used to employ the 210 youths. Corporations contributed $140,000. Pittsburgh project, late under way, was specifically aimed at cleaning up rubble-strewn lots in city. Over 1,000 city-owned lots, most previously unusable, were cleaned and made available for performing arts and other events. Secondary aim was pruning of city trees. Project for Summer, 1983, will begin earlier, and is placing greater emphasis on private-sector job solicitation.

Project Coordinator

Pittsburgh Private Industry Council, Room 401, City-County Building, Pittsburgh, Pennsylvania 15219.

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RICHMOND

Youth Unemployment	N.A.[a]
Numerical Goals	1,500
Youths Employed	1,086
Private Sector Jobs	815
Community or Agency Jobs made possible through cash contributions	271
Corporate Participants	300

Government Participants

Richmond Area Manpower and Planning Department, county governments, school system.

Other Participants

Urban League, ten community organizations, YMCA, Chamber of Commerce.

Employer Recruitment

Personal solicitation by PIC members, letters to CEO's, phone bank staffed by community volunteers.

Youth Recruitment

School system, through announcements by school counselors; YMCA.

Publicity

Press conference at the start of the project. Radio and television spot announcements, newspaper articles.

Miscellaneous

Coordinator obtained a small grant to fund 50 percent of the wages for youths working in small businesses. For Summer, 1983, a more formal system of job solicitation was established, and greater emphasis will be placed on recruitment of college students. Monitoring of results will be computerized.

Project Coordinator

Richmond Private Industry Council, 201 East Franklin, Richmond, Virginia 23219.

[a]According to a survey of 785 high school students in Richmond's East End—a largely black, low-income neighborhood—61 percent of the youths said they could not find a job. However, a survey spokesperson said this figure should be viewed cautiously in light of limitations in administering the survey. Source: Richmond Youth Services Commission, *Youth Needs Assessment: East End.* City of Richmond, February, 1982, p. 52.

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SAN FRANCISCO

Youth Unemployment	23,000 (8.6 percent[a])
Numerical Goals	None
Youths Employed	806
Private Sector Jobs	800
Community or Agency Jobs made possible through cash contributions	6
Corporate Participants	650

Government Participants

State Office of Economic Development, Mayor's Office of Employment and Training (the CETA sponsor).

Other Participants

Several community groups.

Employer Recruitment

Two-week "phone blitz" staffed by 200 community and corporate volunteers calling 6,000 corporations; Mayor's breakfast on St. Patrick's Day for 150 corporate leaders.

Youth Recruitment

School system and community groups register youth for massive "Paint In," a poster-painting competition at City Hall Plaza. Using spray paint on posters, youths created their own graffiti-style advertisements, such as "For a Whale of a Good Worker, HIRE ME" and "9 to 5 Without No Jive—Give James a Chance." The posters, each carrying the central telephone number, were then placed on buses. All the posters were used, but the best ones—selected by a celebrity panel—received special awards. Top prize was a summer job in an advertising firm's art department. The winning poster in 1982 read "Hands Need Work" next to a picture of a hand behind a wire fence.

Publicity

Mayor's breakfast, phone blitz, and paint-in were planned as media events and received broad coverage. Advertising firm that provided the first prize also handled all media contacts on a pro bono basis.

Miscellaneous

According to project coordinator, business community developed increased awareness about local "structural unemployment that goes beyond the problems of summer jobs for youth." Large number of smaller firms contributed funds for internships.

Project Coordinator

San Francisco Private Industry Council, 1748 Market Street, San Francisco, California 94102.

[a]Includes Oakland.

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SEATTLE

Youth Unemployment	17,000 (25.1 percent)
Numerical Goals	250
Youths Employed	276
Private Sector Jobs	—
Community or Agency Jobs made possible through cash contributions	276
Corporate Participants	20

Government Participants

City Department of Human Resources, County Department of Human Resources, Employment and Training Consortium (a city-county corporation serving as prime CETA sponsor), school system.

Other Participants

Private Industry Council, Employment Opportunity Council, and several community organizations.

Employer Recruitment

The CEO of the project's co-coordinator, a major insurance company, personally called other CEO's to request job placements and/or funds. A fund-raising proposal in his name was also sent to area corporations.

Youth Recruitment

Youths who could not obtain regular CETA placements due to government funding cutbacks were referred to the project.

Publicity

Several articles describing the project in area newspapers.

Miscellaneous

Youths were placed either on community projects such as landscaping, greenhouse improvement, gardening, service delivery to senior citizens, and so forth, or in agencies where they performed entry-level clerical tasks. For 1983, a broader publicity campaign is planned, with the aim of finding openings in the private sector. According to the project coordinator, job experience in private companies tends to be more useful to the youths.

Project Coordinators

SAFECO, SAFECO Plaza, Seattle, Washington 98185. Also, Department of Human Resources, 400 Yesler, Seattle, Washington 98104.

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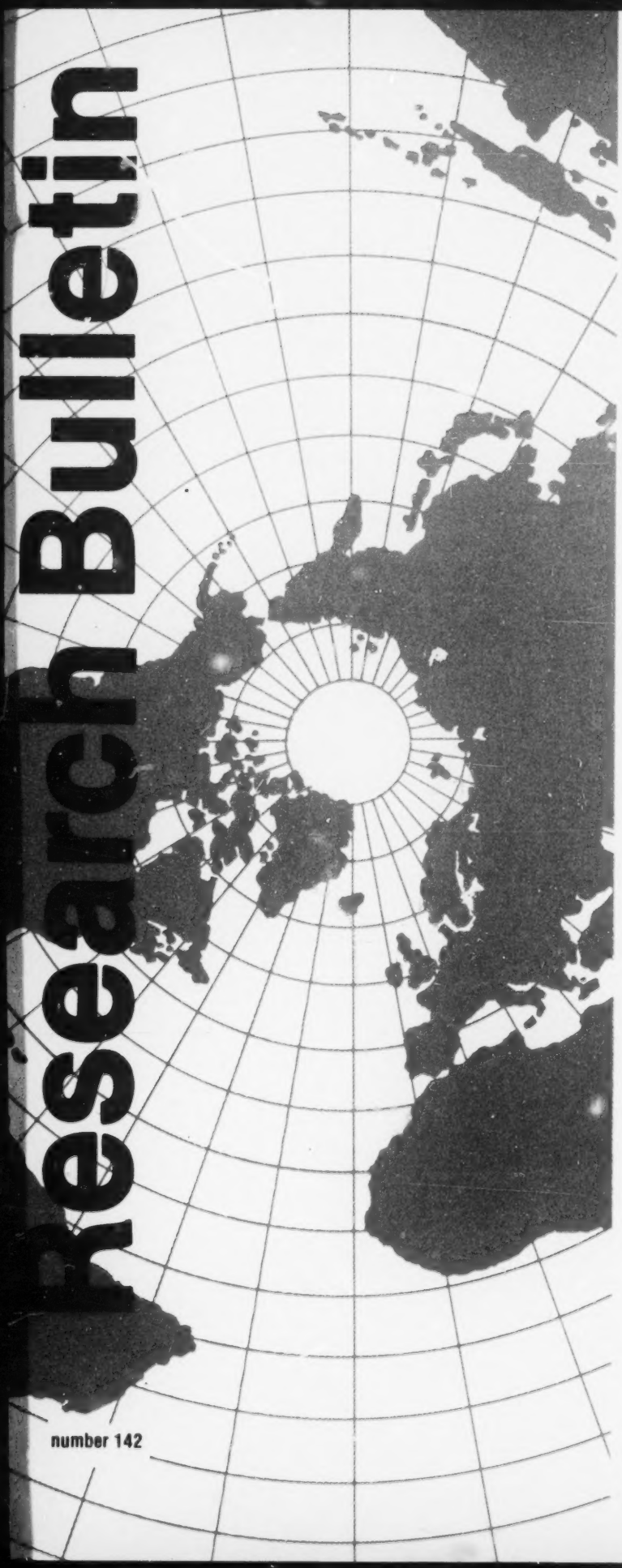
Research Bulletin



Japanese Investment in the United States: An Opinion Survey of Elected Officials

by
Audrey Freedman
and
David Bauer

number 142

The Conference Board

SOURCE OF DATA

The Conference Board surveyed 256 governors, senators and representatives whose state or district contains one or more Japanese-owned manufacturing companies. The list of Japanese-owned companies came from the Japan External Trade Organization. Responses received from 64 elected government officials between October, 1982, and March, 1983, provided the data for this report. Thirty-three of the respondents were governors; fifteen were senators; and sixteen were representatives. There were 34 states represented in this survey.

The Conference Board asked the elected officials the following questions:

1. "Do you think a Japanese business presence is beneficial to the economy of your state?
2. "What are the benefits or drawbacks?
3. "Would you like to see more capital investment by Japan in your state—and if so, in which industries or sectors in particular?
4. "Do you think direct investment from Japan helps reduce trade conflict?

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THE CONFERENCE BOARD, INC.
845 Third Avenue, New York, N.Y. 10022
THE CONFERENCE BOARD OF CANADA
25 McArthur Road, Ottawa, Ontario, K1L-6R3, Canada
THE CONFERENCE BOARD, INC.
Avenue Louise, 207 Bte 5, B-1050 Brussels, Belgium

JAPANESE INVESTMENT in the United States is welcomed, in nearly unqualified terms, by elected state and federal officials. Many states actively seek foreign investment, viewing the capital inflow as a stimulus to technological advance and employment of the local labor force. To the extent that the Japanese facilities involve high technology, however, they are less likely to be labor intensive—particularly of production workers. The elected officials suggested that foreign investment in U.S. production facilities tends to reduce trade conflict, though some responses called for reciprocal openness from Japan on both imports and capital investment.

The Benefits of Japanese Investment

Employment is the main beneficial effect of incoming Japanese capital, according to elected officials (see Table 1). In some cases, "jobs" were cited as the only benefit. Some answers described job creation rippling through the local economy and including domestic employers as well:

> "First, new investment increases job opportunities for Pennsylvania. Second, new investment encourages the establishment and/or growth of complementary businesses which will also increase job opportunities. For example, a manufacturing plant might require certain raw materials, which could be provided by nearby suppliers. Additionally, service industries (supermarkets, banks, etc.) would evolve to provide services for those employed by the firm."

Two respondents noted somewhat ruefully that Japanese investment in heavy industries (such as steel) had "retained" jobs in a shrinking industry. State governors cited a benefit that they mentioned in conjunction with employment, namely, additions to the local tax base. For example:

> "The increased investment adds to the capital stock, which provides the basis for maintaining or accelerating economic growth. This results in the creation of additional tax revenues, jobs and income for residents and helps the state's balance of trade by increasing exports from California to the world's economy."

Stimulation of exports, either from the state or from the United States, was mentioned by nine respondents. In some cases, such exports might be raw materials—such as coal, lumber and agricultural products—exported for processing elsewhere. In other cases, Japanese capital may generate U.S.-based transformation of our raw materials into finished products for domestic and export markets. Such an investment in U.S. processing and manufacturing would be warranted by the cost savings (especially in transportation) of using natural resources on site, or within the country of origin.

However, a broad resource base alone will not "create" manufacturing jobs. It is necessary that U.S. processing and fabrication using those resources be sufficiently cost-efficient to retain the comparative advantage through the stages of manufacturing. If "made in the U.S.A." means poorly made or expensively made, then Japanese (and others, including Americans) will invest in manufacturing facilities located elsewhere.

For this reason, three of the benefits cited are critical to further job growth: (1) the introduction of better production-management techniques, (2) introduction of new technology, and (3) training the U.S. work force. Management innovation was described as "new ideas and new approaches to business and development" and "new methods of production." One West Coast congressman commented: "The long-haul attitude of Japanese firms is something U.S. companies should have. Our managers

Table 1: Beneficial Results of Japanese Investment

Specified Benefit	*Frequency of Mention*
Employment	62
Capital inflow	19
Introduce new business or production management techniques	15
Add to local tax base, revenues	13
Technology transfer to the United States	11
Add to mutual understanding, add diversity of culture	11
Stimulates local (or U.S.) export	9
Provides healthy competition	7
Procurement in United States, stimulates complementary enterprises	5
Decreases U.S. imports	5
Attracts other (Japanese) firms to locality	5
Diversifies industrial mix	4
Trains U.S. work force	3

need educating." There were some specific reference to employee development, such as:

> "Japanese investment, in particular, offers the potential of introducing new management styles to American workers. This could, potentially, increase productivity."

The new management style includes investment in the U.S. human-resource base with which the Japanese managers work:[1]

> "Besides the obvious economic benefits that accrue to a community that attracts a new industrial facility, the Japanese have a strong concern for employee skill development and growth, and effective labor-management relations,"

according to one respondent.

By acquiring new technology, the United States can retain manufacturing that otherwise would migrate to countries with lower costs. With Japanese capital come Japanese engineers and managers—carrying their know-how, according to eleven respondents. More generally, when industries in which more Japanese investment is desired were listed (see Table 3, page 7), a potential technological contribution seems to have been the paramount attraction. Americans hope, as one respondent put it, that "exposure to Japanese production systems and management techniques may lead to improved productivity."

Japanese may have some reservations about sharing, and thus giving up, some of their technological advantage. In an article urging Japanese industry to do just this, technology expert Masanori Moritani of the Nomura Research Institute suggested that it would be difficult:

> "No other nation can equal Japan in enthusiasm for the absorption, accumulation, and improvement of foreign technology. It is highly unlikely that any other country would be able to upgrade imported technology to the point where it would surpass that of the donor country. The West has never shown any great aptitude for improving and upgrading."

Moreover, he added:

> "Japan has a tradition of giving more weight to production than to development, resulting in great attention being paid to the production end of industry. No such trend is seen in either the West or the newly industrializing states. Thus even if other countries initiate production on a development and design level equivalent to Japan's, there is no reason to suppose that the products produced will ever catch up with their Japanese counterparts in terms of quality and reliability."[2]

[1]The Conference Board reported on this investment in Audrey Freedman's, *"Japanese Management of U.S. Work Forces"* Research Bulletin No. 119, 1982.

[2]Masanori Moritani, "A Technological Strategy for Import Expansion," *Economic Eye,* published by Keizai Koho Center, Tokyo, June, 1982, p. 28.

Drawbacks

Very few drawbacks to Japanese investment were cited. Four respondents were concerned that the newcomers might outcompete U.S.-owned firms. One said:

> "The obvious drawback would involve a Japanese plant investment in Wisconsin which is so much more competitive than similar existing firms in the state, for whatever reason, that the 'Wisconsin natives' would lose a large share of their domestic market to the Japanese firm. The result would be a net loss to the state of employment and healthy firms."

Competition was seen as a *drawback* by four respondents and a *benefit* by seven. The ones who saw beneficial effects thought that the introduction of more competition would invigorate American firms, not overwhelm them. One said, for example:

> "New products introduced by Japanese companies stimulate the competitive acumen of our indigenous industries."

Another said Japanese investment

> "expands the competition not at the expense of, but rather with the cooperation of, American workers."

One response expressed concern that a Japanese business presence in defense industries might not be in the national interest. In the area of defense-related research and development, such as electronics, it might be imprudent to allow U.S. firms to be replaced or weakened by foreign-owned companies. Some other drawbacks cited (once each) were: gives Japanese access to U.S. technology; creates reliance on foreign enterprise; establishes foreign ownership of "our" agricultural real estate; creates a potential for "political control" and pressure; draws profits out of the United States. Two respondents generally observed that Japan has not welcomed U.S. exports or U.S. capital reciprocally.

Why are Japanese Companies Here in the First Place?

Spending by foreign firms to build, expand or acquire manufacturing facilities in the United States is growing more rapidly than either the domestic or foreign investment outlays of U.S. companies. The cumulative value of investments in the United States by foreign manufacturing companies currently exceeds $30 billion. The latest official data available, however, are for 1981 (see Table 2). The rate of growth has slackened since 1980 because of recession in this country and abroad. While foreign investment during the remainder of the decade may not maintain its previous growth rate, the foreign presence will continue to expand appreciably.

Investments in the United States by Japanese com-

panies have accelerated faster than those of any other major industrial country. Investments in "brick and mortar" by the Japanese were virtually nonexistent prior to 1970. Therefore, despite the rapid increase, the current value of Japanese *manufacturing* investments—estimated at $1.3 to $1.5 billion—is relatively small. To date, the trading companies of Japan have been that country's major overseas investor, and their U.S. holdings of $4 billion are exceeded only by those of the British. Conference Board data indicate that the recession has not slowed Japanese investment to the same extent as investment from other countries. The rapid growth of Japanese investment vis-a-vis that of other countries is expected to continue throughout the 1980's.

This growth will continue despite the frequent reluctance of Japan to invest in the United States and the often defensive nature of these investments (see box). Until the late 1960's, investment was limited by the Japanese government because of balance-of-payments considerations, and by Japanese firms because of their emphasis on serving the domestic rather than the foreign market. By 1971, however, the Japanese government was encouraging foreign investment as a means of reducing what the 1976 benchmark study of the Commerce Department on foreign firms called an "embarrassing large" official foreign-exchange reserve.[1] At the same time, Japanese firms began to locate manufacturing facilities outside the country, although their motives for doing so were distinctly different from those of most other firms entering the U.S. market.

In general, the early investments were supportive of Japanese exports. These investments were made to establish U.S. marketing and service networks; frequently with the acquisition of a U.S. distributor. Later investments were made to establish manufacturing facilities, but in the words of the Commerce Department study, this was done "with some reluctance as a defense measure of the last resort." Most Japanese companies would have preferred to continue the policy that had been so successful in the 1950's and 1960's, that is, produce in Japan and export to foreign markets.

[1]*Foreign Direct Investment in the United States*, U.S. Department of Commerce, April, 1976.

A JAPANESE POINT OF VIEW: REASONS FOR INVESTING IN THE UNITED STATES

"Reasons for advancing overseas could be broken down into five categories: (1) investment for the purpose of getting around import restrictions (tariff barriers or import quotas) adopted by foreign governments by replacing exports with products manufactured locally; (2) direct investment for the purpose of opening up new markets; (3) switches to overseas production occasioned by Japan's loss of comparative advantage in competitiveness following increases in domestic wages or material costs; (4) investment for the purpose of promoting triangular trade through exports to third-country markets; and (5) investments made as part of technical cooperation projects.'"

[1]Kazutoshi Koshiro, "How Overseas Investment Affects Employment at Home," *Economic Eye*, published by Keizai Koho Center, Tokyo, June, 1982, p. 34.

Table 2: Foreign Direct Investment Position, Selected Countries, in the United States at Year-end 1981
(millions of dollars)

	All Countries	*Canada*	*Germany*	*United Kingdom*	*Switzerland*	*Japan*
All industries	$89,759	$12,212	$7,067	$15,527	$4,368	$6,887
Manufacturing total	29,533	5,787	2,917	5,910	2,731	1,111
Food products	4,791	2,380	25	528	550	57
Chemicals	8,488	162	1,855	1,634	1,243	266
Metals	4,325	1,172	170	962	338	262
Machinery	4,626	1,044	605	585	230	319
Other	7,303	1,030	263	2,202	369	207
Trade	17,734	1,285	2,271	4,362	607	4,128
Finance	7,448	398	301	2,250	225	1,093
Insurance	5,896	402	764	2,360	641	217
Real Estate	4,564	912	183	436	-1	131
Petroleum	17,813	1,547	56	-212	29	7
Other	6,770	1,880	574	420	135	201

Source: U.S. Dept. of Commerce *Survey of Current Business*, August, 1982, Table 10.

By the beginning of the 1970's, a number of factors combined to threaten Japan's growth in these markets, notably the U.S. market. The devaluation of the dollar in 1971 and 1973 raised prices of imported goods to Americans, and lowered the cost of building or buying U.S. production facilities. U.S. protectionism grew. The merchandise trade deficit of 1971 was the first experienced by this country in over 80 years. Subsequent and larger deficits gave rise to increased tariffs and quotas on items such as ball bearings, textiles, motor vehicles, and various steel products. The imposition of tariffs and quotas, coupled with periodic "voluntary" agreements by the Japanese to limit exports of television sets and automobiles, and frequent charges of dumping had ramifications far beyond the individual products involved. Japanese exporters of any product that achieved large market shares in this country had to consider the possibility that U.S. restrictions would limit sales, a consideration that led many firms to establish U.S. production facilities.

Conditions at home also made overseas expansion attractive. Japan's virtually complete dependence on imported oil made a U.S. location more attractive to large energy consumers. Producers of chemical fertilizer products, metal fabricators, and pulp and paper producers sought U.S. sites as pollution controls and a scarcity of land in Japan curbed expansion of facilities; growing scarcities of workers also throttled domestic expansion plans of many firms.

Location

Roughly 300 Japanese firms had manufacturing plants in the United States at the end of 1981. The vast majority of these firms owned 50 percent or more of their 428 U.S. subsidiaries. The Japan Economic Institute, which monitors the activity of Japanese firms on a regular basis, lists 105 of these subsidiaries in California, notably in the Los Angeles area. Data compiled by both The Conference Board and the Institute show that Japanese companies do not exhibit the marked preference for Sunbelt locations commonly ascribed to them. While Georgia and Tennessee have attracted a large number of firms, so also have the "smokestack" states of New Jersey, Michigan, Illinois, New York, Pennsylvania and Ohio (see box).

The success of traditional manufacturing states in attracting Japanese (and other foreign) companies rests upon several factors, one of which is the availability of labor. Japanese producers of industrial products and supplies such as bearings, machine tools, power equipment, medical equipment, control cables, and other goods have chosen these states in no small part because of their supplies of experienced industrial workers.

STATE OUTREACH PROGRAMS

State offices of economic development endeavor to attract capital in the United States, and increasingly from foreign sources as well. At least 17 states have offices in Japan (usually in Tokyo) to promote trade and to market the state as a site for U.S. operations. In addition, some U.S. cities and regions maintain Japanese offices.

Michigan's office in Tokyo was opened ten years ago, but this move was more recent for most states. For example, Pennsylvania responded:

"We have established foreign trade and investment offices in Western Europe, Tokyo and Mexico City. Since the offices were established a little over a year ago, foreign manufacturing operations were attracted to Pennsylvania as a direct result of the efforts of these trade representatives. Currently, there are over 430 foreign-owned firms located in Pennsylvania that provide over 95,000 jobs for Pennsylvanians. In addition, our state has expanded its industrial advertising campaign to include ads in foreign business journals. According to The Conference Board, Pennsylvania ranked fourth among the states in attracting foreign investments between 1979 and 1981. Pennsylvania is proud of these accomplishments and will continue efforts to inform foreign business that Pennslyvania is a good place to do business."

The Governor of North Carolina said:

"We have a North Carolina office in Japan. In North Carolina we have an industrial developer who speaks fluent Japanese. He devotes full time to recruiting for Japan. Japanese investments in our state represent their latest technology."

Maryland's program to attract Japanese investment extends beyond its office in Tokyo:

"To lay the foundation of good will and to establish closer ties with the international business community, Maryland has recently established sister-state relationships with Japan's Kanagawa Prefecture, China's Anhui Province, and France's Region Nord Pas De Calais. The sister-state programs involve educational exchanges, cultural exchanges, and mutual cooperation in industry and foreign trade."

Nevertheless, many Japanese firms in the Sunbelt produce or assemble television sets, fans, plastic parts, textiles and other items whose production is highly automated or does not require large numbers of experienced and highly trained workers. Thus, communities may not always be able to obtain substantial increases in employment *and* gains in labor productivity and technology as a result of Japanese investment, as is suggested by some of the survey responses.

Labor, of course, is only one of the factors that influence plant-location decisions. The availability of agricultural products was a major factor in Kikkoman's decision to locate its soy sauce plant in Wisconsin, and similar considerations brought seafood processors to Alaska, paper and wood companies to Washington, and cotton thread companies to South Carolina. An existing concentration of firms in the same or related industries (including venture capital and R&D companies) brought Japanese producers of semiconductors, microprocessors and other electronic parts to northern California. Access to major markets offered by a location in New York or Illinois has been a pivotal factor for companies making both consumer and industrial products.

Japanese firms are more likely than are firms from other countries to build, rather than to buy, manufacturing facilities. In recent years however, a growing familiarity with the U.S. market and the size and structure of U.S. industry has made companies slightly more easy with the prospect of buying U.S. plants. The recent $52 million purchase of a Firestone Tire and Rubber plant in Tennessee by Bridgestone Tire and the $150 million investment by Toyota in a joint venture with General Motors to produce autos in a renovated GM plant in California would not likely have occurred 10 years ago, although then the Japanese were not under such intense pressure to limit their auto exports.

In Which Industries Is More Investment Sought?

Elected officials want more Japanese-owned business in the U.S., particularly high-technology operations. One-third of the responding officials named "high-technology" as an industry in which Japanese investment is sought. Sixteen responses identified electronics, robotics, biotechnology and so forth, in further specification (see Table 3). It seems likely that responses that identified such industries as auto parts, chemicals, and metals may also have considered a Japanese "high" technology contribution in framing their preferences for Japanese activity.

The emphasis on technology appeared in every answer. For example, a Congressman from Wisconsin wrote:

> "I would encourage Japanese investment here, with no ban or restriction on any particular field but with particular encouragement for modern or hi-tech or frontier industries and services."

Table 3: Industries in Which Japanese Investment is Desired

Industry	*Number of Times Industry was Mentioned*
"High technology" industries	22
Biotechnology	1
Electronics	9
Computers	1
Robotics	4
CAD/CAM (Computer Assisted Design/ Computer Assisted Manufacturing)	1
Aerospace	1
Transportation equipment	3
Autos or auto parts	8
Motorcycles, bikes	1
Small farm equipment	1
Metals	5
"Heavy industries"	2
Manufacturing	3
"Light" manufacturing	2
Consumer products	3
Chemicals	3
Minerals	1
Plastics	1
Oil	1
Pharmaceutical	4
Agricultural	4
Forest products	2
Food	6
Ocean and marine	2
"Services"	2
Research	2
Banking	1
Insurance	1
Transportation service	1

The Governor of Pennsylvania seeks both output of high-technology "products" and their use in manufacturing processes:

> "In particular, the Commonwealth has been encouraging the establishment of production facilities for advanced technology products by Japanese firms as well as other manufacturing facilities which use advanced technology, such as robots."

When respondents indicate a desire for more advanced technology industries, and also cite technology transfer as one of the benefits of Japanese investment here, they are identifying capital-intensive sectors. Yet nearly every response referred to jobs--employment—as the major benefit sought. *The more automation the Japanese bring the less labor-intensive will be their U.S. operations.* This would be true even of service industries. Moreover,

Japan Firm to Assemble Railway Cars in U.S.

Tokyu Car Corp., which has won contracts to supply 93 electric railway cars to Buffalo and Cleveland, is now seeking plants near these cities to assemble the cars.

The Japanese rolling stock maker won an order from the Niagara Frontier Transportation Authority of Buffalo for 33 electric cars and another contract from the Greater Cleveland Regional Transit Authority for 60 cars.

Two prototype cars are scheduled to be shipped to Buffalo this month, but the remaining cars on order from the city are due to be assembled in the U.S. More than 51% of the parts installed on the Japanese chassis are to be procurred locally.

The cars ordered by Cleveland, scheduled to be delivered late this year, will also be assembled at a U.S. plant.

Two other Japanese rolling stock makers may also be looking for U.S. assembly plants soon. Kawasaki Heavy Industries Ltd. is scheduled to supply 325 subway cars to the Metropolitan Transportation Authority of New York. Hitachi Ltd. is to supply 30 subway cars for the Metropolitan Atlanta Rapid Transit Authority of Georgia. Both are expected to assemble the cars in the U.S.

Source: *The Japan Economic Journal*, March 15, 1983, p. 9.

Japanese firms operating here are likely to be highly automated for another reason: poor quality of workmanship or high wage levels of U.S. workers.[4]

Reasons for investment in the United States, from a *Japanese* point of view, will probably determine the target industries no matter what efforts the states make to influence those choices. One of those (Japanese) inducements is availability of raw materials. Two responses addressed this "pull" effect, differently. One said that investment was wanted in "high-tech industries, agricultural products processing facilities, and forest products processing facilities." The other:

> "We are anxious to attract further Japanese investment. But rather than see more traditional Japanese concentration on raw materials (lumber, wheat and metal products), we would welcome investment in high technology, such as assembly plants for electronic consumer goods, and also in other high-technology 'sunrise' industries."

[4]Japan External Trade Organization (JETRO), *Japanese Manufacturing Operations in the United States: Results of the First Comprehensive Field Study*, September, 1981.

A clear inducement to the Japanese to invest in U.S. facilities is the avoidance of trade barriers. Whether these are quotas, or "Buy American" restrictions on the purchase of foreign-made equipment, or tariffs, they can be eluded by producing in the United States. Thus "voluntary" quotas on imported, Japanese-made autos created pressure on Honda, Nissan and now Toyota to assemble (if not entirely manufacture) in the United States. Auto parts manufacture will follow, partly because of the possibility of domestic-content legislation that is now before the Congress.[5] Thus the rising incidence of trade restrictions on such products as autos, electronics and steel may force some defensive investments by Japanese manufacturers in U.S. production facilities. This is one of the purposes of the supporters of domestic-content legislation: "It would curb the alarming rise in foreign sourcing by U.S. companies, while inducing foreign-based companies to invest here."[6]

By February, 1983, however, all four of the biggest auto importers (Toyota, Nissan, Honda and Volkswagen) had U.S. production facilities. An unidentified House staff member said to the New York Times: "If the aim of domestic content legislation is domestic production, then this has to mean less steam for the bill."[7]

Modified "Buy American" clauses in local, state and federal contracts might also bring limited Japanese involvement. For example, a subway-car contract might be let to a foreign firm as the lowest bidder, yet contain clauses requiring a certain portion of components or materials, or some assembly, to be made in the United States (see box for example). The forced nature of such arrangements suggests that the life of an investment so generated will be limited to the completion term of the contract. The potential benefits of this kind of investment, then, would not extend to the list in Table 1.

Trade Conflict

Nearly all the elected officials responded that direct investment from Japan helps to reduce trade conflict. Some of positive responses emphasized international understanding. For example:

> "The more we can understand the Japanese, the less conflict there will be. Japanese job-producing investments may serve to encourage U.S.—Japanese ties by creating goodwill in the population."

[5]The Fair Practices in Automotive Products Act (H.R. 1234) would require a specified proportion of the components of autos sold in the United States to be manufactured here.

[6]Statement of Douglas A. Fraser, President of the UAW, before the House Ways and Means Trade Subcommittee on Auto Content Bill, (H.R. 5133), September 21, 1982.

[7]*New York Times*, March 14, 1983, Section D.

Most, however, referred to the economic issues: trade imbalance and U.S. unemployment. Some of these are excerpted below:

"I feel there is less opposition to Japanese imports when partial manufacture and/or assembly takes place in the United States."

"More voluntary, direct investment from Japan may be the best way to reduce the serious trade friction between our two countries, and help to avert protectionist legislation that can only be harmful in the long run."

"Having Japanese goods produced in the United States leads to lower Japanese trade surpluses vis-a-vis the U.S. market. Much of the friction related to the 'theft' of U.S. jobs could be reduced as those jobs would now be in the United States."

"It's the loss of jobs by Americans, not the trade imbalance, that is so irritating."

A few respondents raised the issue of Japan's import barriers to U.S. goods, for example:

"Investment could be a factor in reducing trade conflict between the two nations. But one must recognize that equitable trade is a two-way street, and that firms in my district should have an opportunity to compete on an equal footing in Japan's domestic market."

Some reservations about Japanese direct investment were expressed by these legislators. One said:

"Whether direct investment from Japan reduces trade conflict may depend largely on the financial behavior of the Japanese firms. To the extent that profits earned in the relatively open markets of the United States are repatriated to the Japanese parent companies rather than reinvested here, Japanese investment in the United States may exacerbate trade conflict.[a] This will be true as long as there is disparity between access to investment in the two countries."

Another said that trade conflict would be reduced only if Japanese investment does not "discourage growth of U.S.-owned or controlled industry." One response suggested more information would be useful, when he commented that investment by Japanese would mitigate conflict only "when the benefits of that investment are clearly spelled out and not misunderstood."

One governor cautioned against using protectionist, or other politically inspired moves, to attract capital investment:

"We would prefer that the investment were made on the basis of sound economic decisions, rather than political ones. This would add much more to the long-term stability of the investments."

[a]Japanese incorporated affiliates in the United States reinvested 90 percent of their 1981 earnings here. European affiliates reinvested 62 percent; Canadian affiliates, 49 percent. *Survey of Current Business*, August, 1982, Table 5, p. 34.

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Research Bulletin

Incentive Stock Option Plans

by Harland Fox

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THE CONFERENCE BOARD, INC.
845 Third Avenue, New York, N.Y. 10022
THE CONFERENCE BOARD OF CANADA
25 McArthur Road, Ottawa, Ontario, K1L-6R3, Canada
THE CONFERENCE BOARD INC.
Avenue Louise, 207 - Bte 5, B-1050 Brussels, Belgium

The climate for granting stock options to key executives has not been better for a good many years. The stock market has been cooperating since August, 1982. In addition, a year earlier, Congress created a new statutory option—the "incentive stock option" (ISO)—which again provides that an option recipient pays no tax at the time the option is exercised; and, if the option is held for a specified length of time, the bargain element is taxed as a long-term capital gain.[1]

By May, 1982, at least 60 percent of a sample of 531 manufacturers listed in the *Fortune* 1,000 industrials and 30 percent of a group of 526 nonmanufacturers had granted new ISO's or planned to in the near future.[2] This *Bulletin* describes the basic characteristics of incentive stock option plans among 189 companies that have granted new ISO's since August 12, 1981. (See box for description of the sample.)

Profile of the Incentive Stock Option

Under a nonstatutory (nonqualified) stock option, an option recipient is taxed at the time the option is exercised: The difference between the option price and the fair market value at the time of exercise is taxed as personal service income. The company receives a corresponding tax deduction for this amount.

Under a statutory (incentive) stock option, the company is allowed no tax deduction but, as already indicated, there are no tax consequences to the executive when the option is exercised. The executive is taxed at capital-gains rates after meeting a specified holding period.[3] To get this special tax treatment an incentive stock option must meet the statutory requirements described below.

The Plan

The option must be granted under a plan approved by the stockholders within 12 months before or after the date of adoption of the plan.

The option must be granted within 10 years from the date the plan is adopted or approved by the stockholders, whichever is earlier. That is, the maximum term of the plan is 10 years.

The plan must spell out the total number of shares which may be issued under options.

The plan must designate the employees, or class of employees, eligible to receive options. However, the typical designation, "key employees," meets this definition.

Terms of the Option

The option price must not be less than the fair market value of the stock at the time it is granted.

The option must be exercised within 10 years of the date of grant.

The option is not exercisable until all ISO's previously granted have been exercised in full or allowed to expire by lapse of time. That is, lower priced, more recent options are blocked by options previously granted at higher prices by this requirement for "sequential exercise."

About the Companies

In the Spring of 1982, The Conference Board obtained information about stock option plans from approximately 1,200 companies; these 1,200 companies included a sample of:

- manufacturers from the *Fortune* 1,000 industrials
- commercial banks with total deposits of $300 million or more
- insurance companies with premium income of $50 million or more
- retailers with sales of $50 million or more
- construction companies from the 200 largest
- gas & electric utilities listed on the New York Stock Exchange.

In late 1982, all companies in the above groups who had granted incentive stock options or both incentive stock options and nonqualified stock options after August 12, 1981 were asked to participate in this study.[1] The total eligible companies and the number that provided data are shown below:

Type of Business	*Total Eligible*	*Participants*	
		Number	*Percent*
Manufacturing	210	145	69%
Commercial banks	32	17	53
Retail trade	24	12	50
Insurance (stock)	8	7	88
Construction	6	3	50
Gas & electric utilities	5	5	100
Total	285	189	66%

[1]Harland Fox, *Top Executive Compensation, 1982 Edition.* The Conference Board, Report No. 827, 1982, pp. 1 and 7.

[1]The ISO was created by Section 251 of the Economic Recovery Tax Act of 1981 (ERTA) and is governed by Section 422A of the Internal Revenue Code. The IRS has not yet published final regulations, but guidance in interpreting the ISO rules has been published in the *Federal Register* 61839 (December 21, 1981).

[2]Harland Fox, *Top Executive Compensation, 1982 Edition.* The Conference Board, Report No. 827, 1982, p. 8.

[3]It should be noted that ISO's exercised after December 31, 1982, create an item of tax preference for purposes of a new alternative minimum tax that can affect very highly paid executives.

The value of individual awards at the date of grant cannot exceed $100,000 per calendar year, plus unused "carryovers." Carryovers are computed annually and equal one-half the amount by which $100,000 exceeds the amount of option for the year. The carryover may be accumulated and used in any of the three succeeding calendar years.

The option is not transferable except by will or the laws of descent and distribution; and, during the lifetime of the recipient, the option is exercisable only by the option recipient.

Company shares already owned by option recipients may be used to purchase ISO's; that is, stock-for-stock exercise is permitted.

Stock appreciation rights (SAR's) are permitted.

The Option Recipient

The option recipient must be an employee of the corporation (or a subsidiary) at all times during the period beginning with the date of grant and ending three months before the date of exercise (or one year before the date of exercise if disabled).

An employee is ineligible for benefits of an ISO if the employee owns more than 10 percent of the voting power of all classes of company stock. However, this limitation does not apply if the option price is 110 percent or more of the fair market value at the time of grant, and the option term is no more than five years.

To receive the tax benefits of an ISO, the option recipient cannot dispose of the stock within two years of the date of grant, nor within one year of the date of exercise. If the option recipient sells the stock during this holding period (a disqualifying disposition), the option gain is taxed as ordinary income and is deductible by the company.

Relationship to Nonqualified Options

Only 29 of the 189 companies in this study have a stock option plan that provides *only* for grants of incentive stock options; 19 of these are new plans and 10 are old plans modified to grant only ISO's in the future. All of the other companies have plans that allow both ISO's and nonqualified options to be granted.

The most obvious role for nonqualified options is to grant them when the desired value of the option is greater than the $100,000-per-year limit imposed on ISO's. With the exception of 14 companies, this is the way that nonqualified options have been used to date. In seven companies, option recipients make their own choices between ISO's and nonqualified options; in four other companies the typical award is a 50-50 split between ISO's and nonqualified options and in three companies *only* nonqualified options are given to lower paid employees, although higher paid executives can receive both ISO's and nonqualified options.

Over the longer term, some companies may use nonqualified options to overcome the "blocking" that sequential exercise of ISO's creates. For example, if there were ISO's outstanding at $50 per share but the market price was $25 when the company wanted to grant new stock options, nonqualified options might be granted so that the old ISO's would not block the exercise of the new grants. However, this process has some of the overtones of "cancelling" prior options and may suggest to shareholders and the general public that management does not expect stock prices to reach the ISO level for a good many years.[4]

Who Participates

Perhaps the most persistent question about stock option plans is how far down into the organization they go. The general answer to this question is illustrated in Chart 1, which shows the lowest of four organizational levels at which at least *some* managers are granted incentive stock options.[5]

At one extreme, 12 (6 percent) of the companies grant options *only* to the top management group, essentially to those executives who report to the chief executive officer and the chief operating officer. Eight of these plans grant options to fewer than 20 executives; none covers more than 75.

At the other extreme, 16 (8 percent) of the plans reach down into the first level of supervision; that is, at least *some* first-line supervisors regularly receive stock options. Only one of these companies expects to grant options to *all* first-line supervisors. Two others expect to grant options to about half of their first-line supervisors, and another three, to 20 to 30 percent. The other three expect to grant options to 10 percent or less of their first-line supervisors.

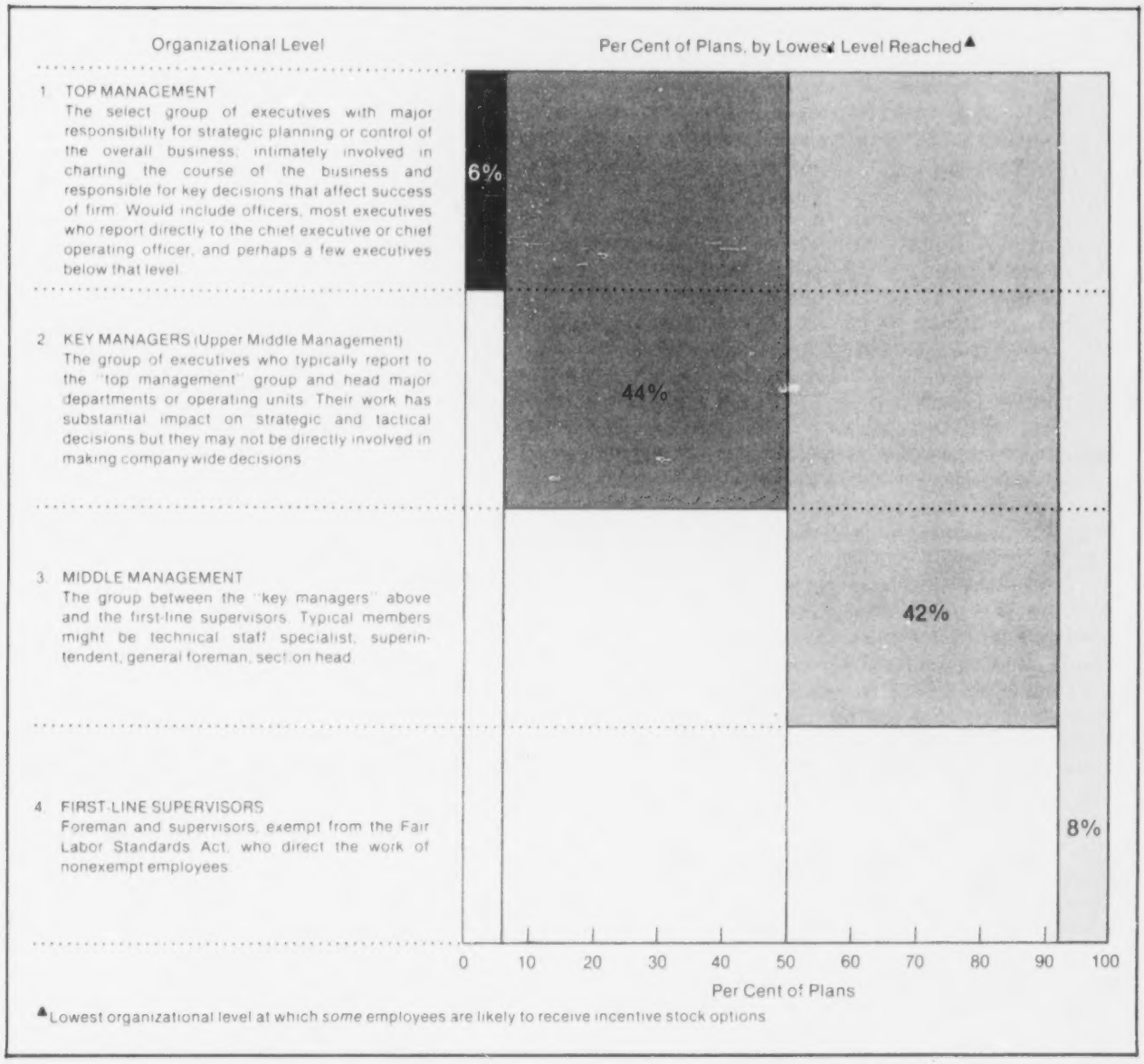
In a word, few first-line supervisors are likely to receive incentive stock options. Almost all plans exclude them entirely and, among those that reach down this far, most do not grant options to a sizable proportion of first-line supervisors.

As Chart 1 illustrates, the remaining plans are split about evenly between those that reach only into the key-

[4]Nonqualified options also may be better than ISO's for highly paid executives subject to the new alternative minimum tax. See Christopher L. Hartwell, "Impact of the New Alternative Minimum Tax on Employee Stock Options," *Taxes*, June, 1983, pp. 407-412.

[5]The definitions of each organizational level as shown on the chart were submitted to the cooperating companies that were asked to indicate the approximate proportion of executives at each of those levels who would be likely to receive options.

Chart 1
Incentive Stock Option Plans, by Organizational Level of Participants


Organizational Level
Per Cent of Plans, by Lowest Level Reached▲
1 TOP MANAGEMENT
The select group of executives with major responsibility for strategic planning or control of the overall business; intimately involved in charting the course of the business and responsible for key decisions that affect success of firm. Would include officers, most executives who report directly to the chief executive or chief operating officer, and perhaps a few executives below that level.
2 KEY MANAGERS (Upper Middle Management)
The group of executives who typically report to the "top management" group and head major departments or operating units. Their work has substantial impact on strategic and tactical decisions but they may not be directly involved in making company-wide decisions.
3 MIDDLE MANAGEMENT
The group between the "key managers" above and the first-line supervisors. Typical members might be technical staff specialist, superintendent, general foreman, section head.
4 FIRST-LINE SUPERVISORS
Foreman and supervisors, exempt from the Fair Labor Standards Act, who direct the work of nonexempt employees.
6%
44%
42%
8%
0
10
20
30
40
50
60
70
80
90
100
Per Cent of Plans
▲Lowest organizational level at which *some* employees are likely to receive incentive stock options.

manager group (upper middle management) and those that go below this into lower middle management, but not as far down as the first-line supervisor. In general, almost all of the key managers as a group are likely to receive stock options; but not all middle managers are likely to. Half of the plans do not cover middle management at all and, among the plans that do, at least one-third expect to grant options to fewer than half of the lower middle-management group.

Salary Level

Another general measure of how far into the organization the stock option plan reaches is the salary level of the *lowest paid* participant. As Table 1 indicates, the median salary of the lowest-paid option recipient is $43,000 in the 180 companies; the middle half range between $33,000 and $54,000.

Of course, the salary of the lowest-paid optionee tends

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Table 1: Salary of Lowest-paid Option Recipient, by Plan Coverage

Salary of Lowest-paid Option Recipient	Total Plans		Plans According to Lowest Organizational Level Reached[1]							
			Top Management		Key Managers		Middle Management		First-line Supervisors	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent
$75,000-$100,000	10	6%	3	25%	7	9%	—	—	—	—
65,000- 74,000	9	5	—	—	9	11	—	—	—	—
60,000- 64,000	11	6	2	17	6	8	3	4%	—	—
55,000- 59,000	10	6	2	17	6	8	2	3	—	—
50,000- 54,000	27	14	3	25	16	20	8	11	—	—
45,000- 49,000	19	11	1	8	9	11	9	12	—	—
40,000- 44,000	25	14	1	8	12	15	12	16	—	—
35,000- 39,000	14	8	—	—	1	1	10	14	3	19%
30,000- 34,000	26	14	—	—	6	8	14	19	6	38
25,000- 29,000	16	9	—	—	7	9	8	11	1	5
15,000- 24,000	13	7	—	—	—	—	7	10	6	38
Total[2]	180	100%	12	100%	79	100%	73	100%	16	100%
Median Salary	$43,000		$56,000		$50,000		$36,000		$30,000	
Middle 50% Range	33,000-54,000		a		40,000-60,000		30,000-45,000		a	

[1]See Chart 1 for definition of organizational levels.
[2]Excludes 4 plans for which information was not obtained.
[a]Too few for calculation.

to be smaller the farther down into the organization the plan goes. As Table 1 indicates, the median salary of the lowest-paid recipients for those plans that cover only the very top executives is $56,000, compared with $30,000 for plans that reach first-line supervisors. Plans that go no lower than key managers or middle management fall between these two extremes; $50,000 and $36,000, respectively, are the median salaries of the lowest-paid option recipients.

Among the plans that cover only key managers or reach into middle management, the lowest-paid optionee in large companies tends to be paid more than a counterpart in smaller companies.

- For example, among manufacturers with plans that cover only key managers (and top executives), the median in 15 companies with sales of $5 billion or more is $67,000, compared with $51,000 in 24 companies with sales in the $1 to $5-billion range and $41,000 in 19 companies with sales under $1 billion.
- Among manufacturers with plans that cover middle managers, the median salary of the lowest-paid option recipient is $50,000 in 13 companies with sales of $5 billion or more; $40,000 in 24 companies with sales of $1 billion to $5 billion; and $30,000 in 27 companies with sales under $1 billion.

To some extent, these differences reflect the fact that larger companies pay more than smaller companies; at the same time, they suggest that larger companies are relatively more restrictive in their definition of a key manager and of middle management.

Number of Participants

The actual number of executives that are likely to be granted incentive stock options under the plans studied here vary widely. Taking all plans together, however, the median plan provides options for 146 executives, with the middle half covering 74 to 358 participants. As Table 2 shows, the number of participants varies according to the lowest organizational level reached. The median number of executives who participate in plans that cover only top management is 30. The median increases to 100 executives in plans that cover key managers (and top executives). The median number of executives in plans that cover middle management or reach first-line supervisors is 225.

Among the plans that cover only key managers (and top executives) and among the plans that reach into middle management, the number of participants increases with company size.

- For example, among manufacturers with plans that cover only key managers, the median number of participants is 400 among 14 companies with $5 billion or more in sales, compared with 107 participants in 22 companies with sales of $1 billion to $5 billion, and only 63 participants in 19 companies with sales under $1 billion.

Table 2: Number of Participants, by Plan Coverage

Number of Participants	Total Plans		Plans According to Lowest Organizational Level Reached[1]							
			Top Management		Key Managers		Middle Management		First-line Supervisors	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent
1,000 or over	12	6%	—	—	—	—	9	11%	3	19%
700-999	9	5	—	—	5	6	4	5	—	—
500-699	12	6	—	—	3	4	8	10	1	6
400-499	9	5	—	—	3	4	5	6	1	6
300-399	12	6	—	—	1	1	9	11	2	13
250-299	8	4	—	—	5	6	3	4	—	—
200-249	18	10	—	—	7	9	7	9	4	25
150-199	11	6	—	—	5	6	4	5	2	13
100-149	30	16	—	—	12	15	18	24	—	—
50-99	36	20	4	33	21	26	8	10	3	19
Less than 50	30	16	8	67	18	23	4	5	—	—
Total[2]	187	100%	12	100%	80	100%	79	100%	16	100%[b]
Median Participants	146		30		100		225		225	
Middle 50% Range	74-358		a		50-210		115-500		a	

[1]See Chart 1 for definition of organizational levels.
[2]Excludes 2 plans for which information was not obtained.
[a]Too few for calculation.
[b]Details do not add to 100 because of rounding.

• Among manufacturers with plans that reach into middle management, the median number of participants in 13 companies with sales of $5 billion or more is almost 700, compared with 375 in 24 companies with sales of $1 to $5 billion, and a median of 132 participants in 32 companies with sales under $1 billion.

As a rule, incentive stock option plans are limited to selected *exempt* employees. Therefore, a more meaningful measure of plan coverage is the number of participants as a percentage of the exempt population. As Table 3 illustrates, the median proportion of exempt employees in all plans is 5.4 percent, with the middle half of the plans covering 2.5 percent to 10 percent of the exempt population. The percentage covered increases significantly the farther down the plan reaches.

Plans that cover only top executives include 1.2 percent of exempt employees, compared with a median of 3.8 percent for plans that cover key managers (and top executives). For plans that cover some middle managers, the median is 8.2 percent of the exempt population; and, for plans that reach first-line supervisors, participants average 15 percent of the exempt employees.

Although the *number* of participants increases as company size increases, the percentage of exempt employees covered tends to *decrease* with increased company size. This is shown below for manufacturers with plans that cover only key managers (and top executives) and those that reach into middle management. (The number of plans on which the median is based is shown in parentheses.)

Total Exempt Employees	Median Percentage of Exempt Employees in Plan	
	Key-Manager Plans	Middle-Management Plans
10,000 and over	1.5% (20)	4.5% (19)
3,000-9,999	2.7 (21)	6.5 (23)
1,000-2,999	5.7 (22)	9.0 (21)
Less than 1,000	7.4 (17)	18.0 (13)

The Size of the Individual Option

Although any number of individual considerations may be reflected in the size of the option granted to a specific executive, position in the management hierarchy and its correlate, salary, generally serve as a basic framework within which the size of individual grants are determined. To get a measure of the size of options, companies were asked to indicate the "value" of the most recent grant to the highest-paid, lowest-paid, and average-paid participants. The "value" of the grant is the product of the market value of a share at the time of grant and the number of shares granted.

In addition to salary, two other factors might influence the size of grants: the term of the option and, more important, the frequency of grants. As the tabulation below indicates, most of the companies grant options every

Table 3: Percentage of Exempt Employees Likely to Receive Options, by Plan Coverage

Number of Participants as Percent of Exempt Employees	Total Plans		Plans According to Lowest Organizational Level Reached[1]							
			Top Management		Key Managers		Middle Management		First-line Supervisors	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent
40-45%	2	1%	—	—	—	—	1	1%	1	6%
30-39	6	3	—	—	3	4%	2	3	1	6
20-29	11	6	—	—	1	1	8	10	2	13
15-19	12	6	—	—	1	1	6	9	5	31
10-14.9	22	12	—	—	3	4	17	22	2	13
9-9.9	2	1	—	—	1	1	1	1	—	—
8-8.9	10	5	—	—	3	4	5	6	2	13
7-7.9	7	4	—	—	4	4	3	4	—	—
6-6.9	13	7	—	—	7	9	5	6	1	6
5-5.9	16	9	2	17%	7	9	6	9	1	6
4-4.9	16	9	1	8	8	10	7	9	—	—
3-3.9	15	8	—	—	10	12	4	5	1	6
2-2.9	20	11	2	17	13	16	5	6	—	—
1-1.9	22	12	4	33	13	16	5	6	—	—
Less than 1%	12	6	3	25	7	9	2	3	—	—
Total[2]	186	100%	12	100%	81	100%	77	100%	16	100%
Median Percent	5.4%		1.2%		3.8%		8.2%		15%	
Middle 50% Range	2.5%-10%		a		2.0%-6.9%		4.3%-13.0%		a	

[1]See Chart 1 for definition of organizational levels.
[2]Excludes 3 plans for which information was not obtained.
[a]Too few for calculation.

year, whether the term of the option is ten years or something less.

Frequency of Grants	Plans, by Term of Option	
	10-Year Term	5-6-7-8-Year Term
1 year	96	11
1-2 years	7	—
2 years	23	3
2-3 years	6	1
3 years	9	1
4 years	6	—
5 years	4	2
Total	151	18

The number of cases is too small to determine the influence, if any, of the length of the option term or the frequency of grants. Therefore, only data for the 96 plans with annual grants and a 10-year option term were used. For the 288 executives in these companies for whom data were obtained, the median value of the most recent option was 49 percent of base salary, with the middle half of the awards ranging from 27 percent to 87 percent of salary. As Table 4 shows, the median award of 90 percent of salary for the highest-paid participant (typically, the chief executive officer) is significantly higher than the median for the average-paid optionee (45 percent of salary), and the lowest-paid participant (30 percent of salary). A more general relationship between salary and the size of the award is illustated in Table 5.

Restrictions on Exercising the Option

The regulations governing incentive stock options require that the term of an individual option can be no longer than ten years; that is, if an executive does not purchase the stock within ten years of the date the option is granted, the option expires automatically.[4] This statutory ten-year term is used in 86 percent (162) of the 189 plans studied here; 12 percent (23) use five years, and the other four set the term at six, seven or eight years.

To encourage an option recipient to remain with the company, most plans restrict the rate at which an executive can exercise an option over the term of the option. This is done by using one or both of the following procedures:

(1) "Waiting Period"—A specified period of time following the date of grant during which the executive cannot exercise *any part* of the option.

[4]This section is concerned with a specific, single grant. Another important restriction is that grants must be exercised in sequence (see page 3).

Table 4: Value of Option for 96 Plans with Annual Grants and 10-Year Option Term

Value of Award[1] *as Percent of Salary*	*Highest-Paid Recipient* *Number*	*Average-Paid Recipient* *Number*	*Lowest-Paid Recipient* *Number*
200% or more	11	—	—
150-199	8	4	—
120-149	10	1	2
110-119	8	2	1
100-109	7	6	2
90-99	4	1	2
80-89	5	2	4
70-79	2	4	2
60-69	9	11	5
50-59	7	13	9
40-49	14	10	10
30-39	3	12	16
20-29	2	18	14
Less than 20%	6	12	29
Total	96	96	96
Median Award	90%	45%	30%
Middle 50% Range	48%-136%	25%-67%	17%-50%
Median Salary	$330,000	$75,000	$48,000
Middle 50% Range	$220,000-$440,000	$62,000-$100,000	$35,000-$60,000

[1]Number of shares x market value at time of grant.

(2) "Installments"—Portions of the total option shares that are released for purchase over a specified period of time.

The various combinations of waiting period and installments are described below for plans with a ten-year option term. (Information for the twenty-three plans with a five-year option term is in the box.)

Only ten (six percent) of the 162 plans with a ten-year option term impose *neither* of these restrictions. That is, an executive can exercise all or any part of the option at any time after the date of grant.

Table 5: Value of Option by Salary, Plans with Annual Grants and 10-Year Option Term

Salary	*Median Grant (Percent of Salary)*	*Number of Executives*[1]
$400,000 and over	116%	34
200,000-399,999	81	47
100,000-199,999	58	47
75,000- 99,999	48	32
50,000- 74,999	36	66
25,000- 49,999	28	56

[1]Excludes 6 paid less than $25,000.

Restrictions in 23 Plans with Five-Year Option Term

No Restrictions—1 plan

Only Installments—1 plan
20 percent becomes exercisable each year

Only a Waiting Period—8 plans
6 plans—one year waiting period
2 plans—two year waiting period

Waiting Period plus Installments—13 plans
waiting period is one year in all.
installment provisions:

6 plans—25 percent of shares are released after one year with another 25 percent each year thereafter.

3 plans—20 percent of shares are released after one year with another 20 percent each year thereafter.

2 plans—50 percent of shares are released after one year with the other half a year later.

2 plans—One third of the shares are released after one year with another one-third each year thereafter.

Installments Only

Four plans with a ten-year option term have no waiting period, but require the option to be exercised in installments. In three of these plans, 20 percent of the shares become exercisable each year. That is, at any time during the first year from the date of grant, the recipient can exercise 20 percent of the option shares; at any time during the second year, another 20 percent is exercisable, and so on. The entire grant is exercisable, therefore, four years after the date of grant.

In the other company, 25 percent is available for purchase during each of the years following the date of grant. Thus, the entire grant is exercisable three years after the date of grant.

A Waiting Period Only

Fifty (31 percent) of the plans with a ten-year option term have a waiting period but no installment provision. These waiting periods are shown below.

Waiting Period	*Number of Plans*
6 months	7
1 year	35
1½ years	1
2 years	5
3 years	2

During a waiting period, no part of the option can be exercised, but after this all shares are available for purchase.

Waiting Period Plus Installments

The remaining 98 (60 percent) of the plans with a 10-year option term have *both* a waiting period and an installment provision. The waiting period is one year in almost all of these plans, as shown below.

Waiting Period	*Number of Plans*
6 months	2
1 year	84
1½ years	1
2 years	9
3 years	2

As would be expected, the installment provision in these plans is related to the length of the waiting period; but even among plans with the same waiting period, the installment provisions vary considerably. For example, among the plans with a ten-year option term and a one-year waiting period, about one-third (29) release 25 percent of the shares at the end of the waiting period, with another 25 percent each year thereafter (Table 6). Thus, all shares are available for purchase four years after the date of grant. In fourteen plans, all shares are not available until five years after the date of grant; 20 percent are released at the end of the waiting period and 20 percent each year thereafter. At the other extreme, 18 plans release all shares within two years of the date of grant; one-half after the one-year waiting period and one-half a year later. The variations among the 14 plans that have a waiting period other than one year are shown in Table 7.

Relation to Holding Period

Under the regulations that govern incentive stock options, there are no tax consequences when the option is granted or exercised, but the recipient is taxed at capital gains rates when the stock is sold. However, to be eligible for this tax treatment, there can be no disposition of the stock within two years of the date of grant or within one year after the exercise of the option. To meet these requirements as soon as possible after an option is granted,

Table 6: Installment Provisions, 84 Plans with One-Year Waiting Period and 10-Year Option Term

	Percent of Shares Released for Purchase Each Year from Date of Grant				
Number of Plans	*1 Year*	*2 Years*	*3 Years*	*4 Years*	*5 Years*
14	20%	20%	20%	20%	20%
29	25	25	25	25	
4	40	20	20	20	
8	33⅓	33⅓	33⅓		
4	50	25	25		
3	40	30	30		
2	30	30	40		
18	50	50			
1	66⅔	33⅓			
1	33⅓	66⅔			

Table 7: Installment Provisions by Length of Waiting Period (Fourteen Plans with Waiting Period Other than One-Year and Ten-Year Option Term)

	Percent of Shares Released for Purchase, by Months from Date of Grant										
	Number of Months										
Waiting Period	*6*	*12*	*18*	*24*	*30*	*36*	*42*	*48*	*54*	*60*	*72*
6 months											
1 plan	20%	20%		20%		20%		20%			
1 plan	25	25		25		25					
18 months											
1 plan			40%		20%		20%		20%		
2 years											
1 plan				20%		20%		20%		20%	20%
1 plan				25		25		25		25	
2 plans				50		25		25			
2 plans				33⅓		33⅓		33⅓			
1 plan				50		30		20			
1 plan				25		25		50			
1 plan				50		50					
3 years											
2 plans						50%		50%			

all option shares would have to be available for exercise within one year of the date of grant. Barely one-third (60) of the 189 incentive stock option plans have a waiting period or installment provision that allows an executive to exercise *all* shares within one year from the date of grant (52 of the 162 plans with a ten-year option term; seven of the 23 with a five-year option term; and one of the four plans with a six-, seven- or eight-year term).

In addition, the sequential exercise provisions for ISO's may make it *impossible* for options to be exercised according to the installment schedule in some plans. For example, if a company makes annual grants and, under each grant, 25 percent may be exercised in each of four annual installments, then the first installment of the *second* grant cannot be exercised until the fourth installment of the first grant is exercised. The regulations state that the sequential exercise restriction would limit the exercise of any ISO granted later until either the exercise or expiration of all installments of the ISO granted earlier.

Stock Appreciation Rights

A stock appreciation right (SAR) gives an optionee, in lieu of exercising the stock option, the right to receive from the company an amount equal to the appreciation in the stock price since the date of grant. This gain is taxed as ordinary income to the executive at the time it is received and the company gets a tax deduction.

The primary purpose of an SAR is to provide an executive with the opportunity to receive the market gain in an option without the cost of borrowing money to purchase the stock, and without the investment risk of a subsequent decline in the price of the stock. Furthermore, if the executive is an "insider," exercising the SAR cancels out the risks created by the SEC requirement that purchased option shares be held for six months before they may be sold. Also, because the exercise of the SAR cancels the underlying option right, the company has to use relatively fewer shares for the plan over time.

The regulations specifically allow a "tandem ISO-SAR"; however, the SAR must have the following characteristics:

- The SAR can expire no later than the expiration of the underlying ISO.
- The SAR payment cannot exceed the option gain at exercise.
- The SAR is transferable only when the related ISO is transferable (e.g., at death) and only under the same terms.
- The SAR is exercisable only when the related ISO is exercisable.
- The SAR may be exercised only when the related ISO is valuable. That is, the SAR may not be exercised when the ISO is under water as a device for freeing a valuable ISO granted later.

Approximately 45 percent (85) of the incentive stock option plans provide for stock appreciation rights. However, among the 29 plans that grant *only* ISO's, only 21 percent (six) provide SAR's. Similarly, among the 160 plans that grant both ISO's and nonqualified options, 21 percent (34) provide SAR's only for the nonqualified grants—not for ISO's. Almost half (49) use SAR's for

both ISO's and nonqualified options; and the remaining 29 percent (47) do not use them for either.

Among 75 incentive stock option plans for which information was obtained, 30 plans provide SAR's for all who receive an option, but the other 60 percent (45 plans) grant SAR's *only* to officers and members of top management who are subject to Section 16 (b) of the Securities and Exchange Act. (This includes 12 plans that cover a somewhat broader group of top management as well.)

Under this rule, profits from a purchase and sale by these "insiders" of company stock within a "short-swing" period of less than six months can be recovered by the company. However, under SEC Rule 16b-3, *cash* received on the complete or partial settlement is not subject to this "short-swing" provision if the exercise of the SAR, and the election of the cash payment, is made during a "window period": A period that starts on the third business day and ends on the twelfth business day following the release of annual or quarterly company financial statements. In addition, the underlying stock option must have been outstanding for at least six months, and a "disinterested" committee responsible for plan administration must consent to any election for SAR payments in cash.

If stock is issued for full or partial payment of an SAR, the transaction remains subject to Section 16 (b); that is, the stock cannot be sold for six months. However, as protection against a fall in the stock price during this period, the determination of the amount of taxable income can be postponed for the six months.

The major reason for limiting SAR's to this "insider" group (or any other small group of top executives) is the cost of the SAR to the company. SAR payments are a compensation expense and, therefore, reduce reported net income and earnings per share. Because the cost is the increase in price of company stock after the date of grant of the SAR, the very grant of the SAR introduces an unknown cost that can be very large. In addition, gains in the value of the SAR must be accrued and reported during the period that SAR's are outstanding. Therefore, considerable volatility can appear in a company's income statement because the compensation expense credited or debited is based on the stock price at the beginning and end of each fiscal quarter. Furthermore, current accounting procedures assume that all SAR's will be exercised and not the underlying options; accrued SAR expense cannot be reversed even if the option is exercised. (This is treated as consideration for stock issued.)

It is possible that SAR experience under ISO's will be quite different than under nonqualified options, where the SAR usually was exercised rather than the option. First, there is no tax at the time of exercise of an ISO as there is for a nonqualified option. In addition, the possibility of capital gains tax on the bargain element of the ISO may outweigh the need to borrow money for exercise. Therefore, fewer SAR's may be exercised under ISO's, cutting the cost of SAR's appreciably.

It should be noted that two other devices for limiting the cost of SAR's are used in the incentive stock option plans studied here. Two of the eighty-five ISO's limit SAR payments to no more than 100 percent of the option price; and one to 200 percent. In another eight plans, the SAR applies to only half of the shares granted. That is, the executive must purchase half of the shares; the SAR payment is made in cash to provide the executive with funds to pay taxes on the stock gain. This procedure also is an attempt to encourage the executive to hold on to option stock. Other plans also may do this by administrative rules in which payment of the SAR is partially or entirely paid in company stock.

Stock Swaps

In September, 1980, the Internal Revenue Service in Revenue Ruling 80-244 endorsed stock-for-stock exercise (stock swaps) for *nonqualified* options. Under this arrangement, nonqualified options can be exercised with previously purchased stock, in lieu of cash, and the tax on any gain in the old stock is postponed. Thus, the executive uses pre-tax dollars to exercise the option.

For example, suppose an executive owns stock previously purchased at $10 per share, and has an option to purchase 100 shares at $20 per share when the current market value of company stock is $40 per share. To exercise the option, the executive gives the company 50 previously purchased shares with a current market value of $2,000 (50 shares X $40); in return, the executive receives all of the option shares (100 shares X $20 = $2,000). Operationally, the swap of the 50 previously owned shares for 50 of the option shares is not considered a taxable transaction, and the tax basis of $10 is retained.[7]

The value of the other 50 shares, $2,000 (50 shares X $40), represents the bargain element and is taxed as ordinary income; the tax basis is $40. If this same logic is applied to *incentive stock options*, the value of the 50 shares representing the bargain element would not be taxed until sold, and the tax basis of the stock would be zero.

Although the law specifically allows an executive to exercise an incentive stock option with previously acquired company stock, the use of this provision for ISO's has been effectively barred because the IRS has refused to rule that there will be no tax on the appreciated value of

[7]Optionees do not have to actually deliver the shares to the company; they merely attest that they own a sufficient number of shares. The company issues a certificate only for the new shares acquired, which represent the bargain element.

the old stock which is surrendered for an ISO. In addition, the IRS has questioned the "tax-free SAR" effect of not taxing the shares that represent the bargain element.

Whatever the final version of the general stock-for-stock rules, the use of a stock-for-stock variant, called "pyramiding," already has been eliminated for ISO's. "Pyramiding" is a procedure in which an executive first tenders a small number of shares and then, in a succession of stock swaps, converts this small investment into shares that represent the bargain element.

For example, suppose the executive in the illustration above had only 20 previously purchased shares, not the 50 needed to exercise the full nonqualified option. The executive could turn in the 20 shares valued at $800 (20 shares X $40) and purchase 40 option shares (40 shares X $20 = $800). To exercise the remaining 60 option shares, the executive needs $1,200 (60 shares X $20); therefore, the executive delivers 30 of 40 shares now held (30 shares X $40 = $1,200). After this last transaction, the executive has exercised his full option for 100 shares. Starting out with only 20 previously owned shares, the executive has 70 shares with a value of $2,800; 20 shares represent the initial shares and the other 50 shares represent the bargain element of the option, $2,000.

Obviously, the executive could have started the process with even fewer than 20 shares and, with a larger number of successive swaps, reached the same result. This "pyramiding" is not possible under an incentive stock option plan because ERTA was subsequently amended (effective March 15, 1982) to provide that *statutory* stock option shares tendered for ISO shares must be held the required waiting period (two years after grant, and one year after exercise in the case of ISO's) without being deemed "sold" in a disqualifying disposition.

The status of one other aspect of stock-for-stock exercise has not been entirely resolved. The net result of a stock swap is that the executive receives the same net increase in stockholdings that would have been received with an SAR settled in stock. But unlike an SAR, there is no charge to earnings. Accounting firms may require a charge in some form.

In any event, almost three-fourths (138) of the incentive stock option plans in this study provide for stock-for-stock exercise.

Number of Shares Authorized

Few (39) of the plans studied here are new plans, recently adopted to provide only incentive stock options: Only 19 companies have a new incentive stock option plan as the only plan in the company; another 20 companies have a new ISO plan but also have another, older plan for nonqualified options only. All of the other 150 companies have plans initially adopted to provide nonqualified options but modified recently to provide incentive stock options as well. (Eight of these companies have two nonqualified plans, both of which have been modified to grant ISO's, too.)

Therefore, the 213 plans for which data on the number of shares authorized are available are a mixture of plans adopted during the past ten years, including some plans that do not provide for incentive stock options. Most of the plans have a term of ten years, but thirty have a term of only five years. These five-year plans have been excluded from the analysis (as well as thirty-four of the ten-year plans for which data were not available).

As Table 8 indicates, the typical ten-year plan authorized 750,000 shares, with the middle half ranging between 300,000 shares and 1.2 million. It would be expected that the greater the number of participants in a plan, the larger the number of shares earmarked for the plan. Although the number of cases is small, the tabulation below suggests the nature of this relationship.

Number of Participants	*Number of Plans*	*Median Authorized Shares*
400 and over	31	2.1 million
200-399	30	900,000
100-199	37	725,000
50-99	33	500,000
Less than 50	18	250,000

As Table 9 indicates, the number of shares reserved for options, as a percentage of total shares outstanding, is typically 4.1 percent, with the middle half ranging from

Table 8: Number of Shares Authorized for 10-Year Plans

Number of Shares	*10-Year Plans*	
	Number	*Percent*
4 million and over	6	4%
3 million	8	5
2.1 million - 2.9 million	6	4
2 million	10	7
1.1 million - 1.9 million	14	9
1 million	15	11
900,000 - 999,000	6	4
800,000 - 899,000	5	3
700,000 - 799,000	8	5
600,000 - 699,000	8	5
500,000 - 599,000	14	9
400,000 - 499,000	8	5
300,000 - 399,000	12	8
200,000 - 299,000	19	14
100,000 - 199,000	10	7
Total	149	100%
Median	750,000 shares	
Middle 50% Range	300,000-1.2 million	

3.1 to 5.7 percent. However, this percentage decreases significantly as the total number of outstanding shares increases. The median for companies with less than 5 million shares outstanding is 6.0 percent, compared with 4.5 percent in companies with 5 to 20 million shares outstanding, and 3.5 percent in companies with 20 million or more shares outstanding.

For the most part, the shares of common stock which can be used for a stock option plan are authorized but unissued shares, either as the sole source of stock or in conjunction with treasury shares or with treasury shares and "market" shares.

As the tabulation shows, 62 percent of the plans allow authorized but unissued shares; 64 percent can use treasury shares (shares reacquired by the company but not specifically for stock option use); and 37 percent are allowed to use shares purchased in the market specifically for stock option use.

Allowed Source of Shares	*Plans*	
	Number	*Percent*
Unissued only	59	31%
Treasury only	15	8
Market only	5	3
Treasury and Market	2	1
Unissued and		
Treasury and Market	59	31
Treasury	45	24
Market	4	2
Total	189	100%

Table 9: Shares Authorized for 10-Year Plans, by Percent of Total Outstanding

Option Shares as Percent of Total Outstanding	*Total Plans*		*Plans by Total Shares Outstanding*					
			Less than 5 Million		*5-19.9 Million*		*20 Million and over*	
	Number	*Percent*	*Number*	*Percent*	*Number*	*Percent*	*Number*	*Percent*
15% and over	3	2%	3	13%				
10-14.9	9	6	4	16	5	9%		
9-9.9	2	1	—	—	2	4		
8-8.9	4	3	—	—	4	6		
7-7.9	6	4	2	8	2	4	2	3%
6-6.9	11	7	3	13	3	5	5	7
5.5-5.9	6	4	3	13	2	4	1	1
5.0-5.4	13	9	2	8	7	12	4	6
4.5-4.9	15	10	3	13	5	9	7	10
4.0-4.4	11	7	1	3	3	5	7	10
3.5-3.9	20	14	3	13	6	11	11	17
3.0-3.4	16	11			7	12	9	13
2.5-2.9	12	8			5	9	7	10
2.0-	14	9			2	4	12	19
Less than 2%	7	5			4	6	3	4
Total	149	100%	24	100%	57	100%	68	100%
Median	4.1%		6.0%		4.5%		3.5%	
Middle 50% Range	3.1-5.7		4.7-10.2		3.0-6.7		2.5-4.6	